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BEFORE THE ARIZONA CORPORATION COMMISSION

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DOCKET NO. W-01445A-03-0559

**INITIAL CLOSING BRIEF OF
CORNMAN TWEEDY 560, LLC**

IN THE MATTER OF THE APPLICATION
OF ARIZONA WATER COMPANY, AN
ARIZONA CORPORATION, TO EXTEND
ITS EXISTING CERTIFICATE OF
CONVENIENCE AND NECESSITY AT
CASA GRANDE, PINAL COUNTY,
ARIZONA.

Pursuant to the Procedural Order dated April 16, 2009, Cornman Tweedy 560, LLC ("Cornman Tweedy"), through counsel undersigned, hereby files with the Arizona Corporation Commission ("Commission") its Initial Closing Brief in this Commission-ordered A.R.S. §40-252 remand proceeding ("Remand Proceeding") in the above-referenced matter.

I. INTRODUCTION.

Despite the lengthy procedural history of this case, the issues to be addressed in this Remand Proceeding are quite simple and are clearly set forth by the Commission in Decision 69722 issued July 30, 2007 ("Decision"). In ordering this Remand Proceeding, the Commission stated:

[W]e are concerned that there may not be a current need or necessity for water service in the portions of the extension area that are owned by Cornman. We also recognize that Cornman does not wish to have its property included in Arizona Water's CC&N at this time. We believe that these issues bear further examination and that they may have some relevance to the best interests of the area ultimately to be served.

* * *

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1 [R]egarding the property that is owned by Cornman, we would like an
2 opportunity to consider the overall best interests of the Cornman area and
3 of the public. We will therefore reopen the record in this matter pursuant
4 to A.R.S. §40-252 and remand this case to the Hearing Division for further
proceedings regarding whether Arizona Water should continue to hold a
CC&N for the Cornman extension area at this time.¹

5 Based upon the explicit direction of the Commission in ordering this Remand
6 Proceeding, the issues to be adjudicated regarding the "overall best interests of the
7 Cornman area and of the public" include the following:

8 1. Is the public interest best served by a Commission preference for
9 integrated water and wastewater providers over stand-alone water providers;

10 2. Is there a current need and necessity for water service for the
11 Cornman Tweedy Property, as hereinafter defined;

12 3. What weight should be accorded the fact that Cornman Tweedy
13 does not wish to have its property included within the Certificate of Convenience and
14 Necessity ("CC&N") of Arizona Water Company ("AWC") (*i.e.*, there is no request for
15 utility service); and

16 4. Does it serve the overall public interest for AWC to possess a
17 CC&N for the Cornman Tweedy Property.

18 The evidence that Cornman Tweedy presented in this Remand Proceeding through
19 its pre-filed testimonies and legal briefs goes directly to these issues.² Based upon this
20 evidence, much of which is uncontroverted by AWC, the Commission should amend the
21 Decision to exclude the Cornman Tweedy Property from AWC's CC&N.

22 **II. BACKGROUND.**

23 In order to provide proper context for the legal and factual arguments raised in
24 this docket, it is necessary and important to outline the circumstances that preceded this
25 Remand Proceeding. In Decision 66893 (April 6, 2004), the Commission conditionally

26 ¹ Decision at page 4, lines 1-5 and lines 12-16.

27 ² Cornman Tweedy hereby incorporates herein the legal analysis and arguments set forth in the pleadings
28 that it has previously filed in this docket and specifically, *Cornman Tweedy's Response to AWC's Motion to Strike and Pre-Hearing Brief on Legal Issues* filed February 15, 2008.

1 approved the extension of AWC's CC&N to include approximately 11 square miles in
2 Pinal County, Arizona ("Conditional Extension Area"). Included in the Conditional
3 Extension Area are 1,138 acres owned by Cornman Tweedy ("Cornman Tweedy
4 Property"). The Cornman Tweedy Property constitutes approximately one-half of a
5 contiguous 2,344-acre tract of land referred to as EJR Ranch that will some day be
6 developed as a master-planned development. More than half of the EJR Ranch property
7 is within the CC&N of Cornman Tweedy's affiliate, Picacho Water Company, and it is
8 contiguous to the Conditional Extension Area. All of the EJR Ranch property is within
9 the sewer CC&N of Cornman Tweedy's affiliate, Picacho Sewer Company. Picacho
10 Water Company and Picacho Sewer Company are operated as an integrated utility.

11 Although the Conditional Extension Area covers 11 square miles, AWC
12 submitted only two requests for service with its original application: one from the
13 developer of a project once known as Florence Country Estates, a 240-acre parcel that is
14 now owned by Cornman Tweedy and included as part of the Cornman Tweedy Property;
15 and one from the developer of a project known as Post Ranch, a 480-acre parcel owned
16 by Harvard Investments.³ Decision 66893 was conditioned upon AWC filing copies of
17 certificates of assured water supply and main extension agreements for Florence Country
18 Estates and Post Ranch within 365 days of Decision 66893, or by April 6, 2005.⁴
19 Pursuant to the ordering language of Decision 66893, if AWC failed to satisfy these
20 conditions within the specified time, then the decision was to be "deemed null and void
21 without further order of the Arizona Corporation Commission."⁵

22 AWC had failed to satisfy either of the conditions as the compliance deadline
23 approached, and on March 30, 2005, AWC filed a Request for Additional Time to
24 Comply with Filing Requirements of Decision 66893 (the "Extension Request") asking
25 for an additional 365 days to comply with the conditions. On June 12, 2007, the
26 Administrative Law Judge ("ALJ") issued a Recommended Opinion and Order ("ROO")

27 ³ Decision No. 66893 at Finding of Facts ("FOF") 11 and 12.

28 ⁴ *Id.* at FOF 9 and page 7, lines 1-6.

⁵ *Id.* at 7, lines 7-9.

1 which found that AWC had complied with the conditions imposed in Decision 66893, a
2 finding which Cornman Tweedy contested. The ROO was scheduled for consideration
3 by the Commission at its June 26-27, 2007 Open Meeting.

4 On June 21, 2007, Cornman Tweedy filed exceptions to the ROO requesting that
5 the Commission exclude the Cornman Tweedy Property from the area conditionally
6 granted in Decision 66893. On June 22, 2007, Chairman Gleason docketed Gleason
7 Proposed Amendment #1 which, if adopted, would have excluded the Cornman Tweedy
8 Property from the area conditionally granted in Decision 66893. At the June 26-27 Open
9 Meeting, there was extensive discussion among the Commissioners, the ALJ and the
10 Legal Division regarding whether the Commission could adopt Gleason Proposed
11 Amendment #1 without subjecting the Commission to a potential claim by AWC that the
12 Commission failed to provide procedural due process. Specifically, the Commission
13 discussed whether AWC had received adequate legal notice that it could lose a portion of
14 the CC&N area conditionally granted in Decision 66893. As a result of the discussion,
15 the Commissioners elected not to vote on the ROO at that time in order to have more
16 time to consider Gleason Proposed Amendment #1 and to consider possible alternative
17 amendments that would ameliorate any due process concerns.

18 The ROO was rescheduled for consideration at the July 24-25, 2007 Open
19 Meeting. On July 19, 2007, Chairman Gleason docketed Gleason Proposed Amendment
20 #3 which contained the following language which was ultimately incorporated into the
21 final decision:

22 After considering the evidence in this matter, we are concerned that there
23 may not be a current need or necessity for water service in the portions of
24 the extension area that are owned by Cornman. We also recognize that
25 Cornman does not wish to have its property included in Arizona Water's
26 CC&N at this time. We believe that these issues bear further examination
and that they may have some relevance to the best interests of the area
ultimately to be served.

27 We also recognize that the proceeding before us is limited to relatively
28 narrow issues: whether, for purposes of compliance, Arizona Water

1 should be granted an extension of time to fulfill the conditions of
2 Decision No. 66893 and whether, in fact, those conditions have been
3 fulfilled. We have concluded that these conditions have been fulfilled,
4 and we therefore recognize that, by the terms of Decision No. 66893,
5 Arizona Water holds a CC&N for the extension areas at issue in this
6 proceeding.

7 Nonetheless, regarding the property that is owned by Cornman, we would
8 like an opportunity to consider the overall best interests of the Cornman
9 area and of the public. We will therefore reopen the record in this matter
10 pursuant to A.R.S. §40-252 and remand this case to the Hearing Division
11 for further proceedings regarding whether Arizona Water should continue
12 to hold a CC&N for the Cornman extension area at this time. We
13 recognize that Arizona Water, as the CC&N holder, is entitled to
14 appropriate notice and an opportunity to be heard. We therefore
15 officially place Arizona Water on notice that our subsequent proceeding
16 on remand will be for the purpose of considering whether the Cornman
17 property should be deleted from the CC&N extension granted to Arizona
18 Water by Decision No. 66893. The Hearing Division is directed to
19 conduct further evidentiary proceedings in this matter, including
20 appropriate opportunities for intervention and an appropriate opportunity
21 for Arizona Water to present its case.

22 While the matter currently before us presented relatively narrow issues,
23 we view the proceeding on remand as broad in scope so that the
24 Commission may develop a record to consider the overall public interest
25 underlying service to the Cornman property that is included in the
26 extension area granted by Decision No. 66893. By identifying these
27 issues and requiring further proceedings, we are not prejudging this
28 matter in any way; instead, we merely desire an opportunity to consider
the broader public interests implicated herein. (Emphasis added)⁶

At the July 24-25 Open Meeting, there was considerable discussion regarding
whether Gleason Proposed Amendment #3 would fully resolve any legal concerns
regarding proper notice to AWC, and whether remanding the proceeding under A.R.S.
§40-252 to permit the broader public interest discussion the Commissioners desired was
the best way to achieve the Commissioners' objectives. Cornman Tweedy urged the
Commission that the law would permit the Commission to simply expand the scope of
the prior proceeding regarding AWC's request to extend the compliance deadlines in

⁶ Gleason Proposed Amendment #3 prepared on July 19, 2007; Decision at page 4, lines 1-22.

1 Decision 66893 and remand the matter back for additional evidentiary hearings on the
2 broader public interest issues. However, concerns persisted that such a course of action
3 might not comport with the Commission's notice requirements, thus subjecting the
4 Commission to a legal challenge by AWC. Ultimately, the Commission adopted
5 Gleason Proposed Amendment #3 and it was incorporated into the final Decision.

6 The Commissioners' extensive discussions at the June 26-27 and July 24-25 Open
7 Meetings, the adoption of Gleason Proposed Amendment #3, and the plain language of
8 the Decision itself leave no doubt that the Commissioners intended this Remand
9 Proceeding to be broad in scope to develop an evidentiary record regarding the public
10 interest underlying utility service to the Cornman Tweedy Property. Likewise, there can
11 be no doubt that the Commissioners believed that their unanimous adoption of Gleason
12 Proposed Amendment #3 accomplished their objective, consistent with the procedural
13 due process interests of AWC.

14 Pursuant to a November 8, 2007, procedural order in this matter, a procedural
15 schedule was established, the parties pre-filed written testimony, and a hearing was
16 scheduled for February 14, 2008. On February 7, 2008, AWC filed a Motion to Strike
17 various portions of Cornman Tweedy's pre-filed testimony and the hearing date was
18 continued. The ALJ subsequently denied AWC's Motion to Strike and the hearing was
19 rescheduled for December 15, 2008. However, due to the unexpected illness of AWC's
20 counsel, the December 15 hearing was briefly convened and then continued until January
21 29, 2009. On January 23, 2009, Cornman Tweedy filed a motion to continue the hearing
22 because its primary witness required treatment for a serious illness. The hearing was
23 continued and a procedural conference was scheduled for February 6, 2009. Cornman
24 Tweedy then learned that another of its witnesses required medical treatment for an
25 illness. Thus, two of Cornman Tweedy's three witnesses in the case were not available to
26 testify until May 2009 at the earliest.

27 Counsel for Cornman Tweedy contacted counsel for AWC to discuss how best to
28 accommodate the procedural schedule given the medical issues facing Cornman

1 Tweedy's witnesses. Both parties agreed that because of (i) the extensive record that has
2 already been developed in this case; (ii) the uncertainty regarding when a hearing might
3 ultimately take place in light of the witnesses' medical issues; and (iii) the fact that the
4 parties have already submitted pre-filed testimony, rebuttal testimony and pleadings in
5 this Remand Proceeding and in the earlier proceedings, the matter could be submitted on
6 the pre-filed testimony, the pleadings in the record and closing briefs without the need
7 for a hearing. Counsel for Cornman Tweedy and AWC also discussed with Utilities
8 Division Staff counsel the proposal of proceeding without a hearing as detailed above,
9 and Staff counsel had no objection.

10 At the February 6, 2009, procedural conference, Cornman Tweedy and AWC
11 proposed to the ALJ that the case be decided on the pre-filed testimony, pleadings and
12 closing briefs. The ALJ stated that before she ruled on this request, Cornman Tweedy
13 and AWC should file a motion that sets forth the proposal of the parties regarding how
14 the matter should be brought to a conclusion. On March 6, 2009, Cornman Tweedy and
15 AWC jointly filed a Motion for Submission of Matter on the Pleadings ("Joint Motion")
16 that proposed a procedure for concluding the case without a hearing. On April 16, 2009,
17 the ALJ issued a Procedural Order finding that the procedure proposed by Cornman
18 Tweedy and AWC in the Joint Motion was reasonable and ordered the filing of an initial
19 closing brief by Cornman Tweedy, a response brief by AWC, and a reply brief by
20 Cornman Tweedy.

21 **III. THE OVERALL BEST INTEREST OF THE PUBLIC IS FOR THE**
22 **CORNMAN TWEEDY PROPERTY TO BE SERVED BY AN**
23 **INTEGRATED WATER AND WASTEWATER PROVIDER AT SUCH**
24 **TIME AS THERE IS A NEED AND NECESSITY FOR SERVICE AND A**
REQUEST FOR SERVICE.

25 The evidence presented by Cornman Tweedy shows that the Commission has an
26 express preference for integrated water and wastewater providers over stand-alone water
27 providers, and this preference has never been controverted by AWC, a stand-alone water
28 provider. In his direct testimony, Mr. Poulos testified as follows:

I believe the Commission must take into account the opportunity for integration of water and wastewater services in order to "consider the overall public interest underlying service to the Cornman property" as set forth in Decision 69722. There is no doubt that integration of water and wastewater services is very important to the Commission and an issue the Commission is addressing at this time. In the Rulemaking I discussed above, the Commission proposed and approved additions to Rule R14-2-402 which address integration of water and sewer operations. At the Open Meeting held January 15, 2008, Commissioner Mayes proposed two amendments to Rule R14-2-402 and Commission Gleason proposed one amendment, all three of which dealt with integration of water and wastewater service, encouraging the use of reclaimed wastewater and conserving groundwater. Each of the amendments passed on a 5-0 vote and were incorporated in Decision 70128.

In addition to the amendments adopted in the Rulemaking, in a 2007 article entitled *Encouraging Conservation by Arizona's Private Water Companies: A New Era of Regulation by the Arizona Corporation Commission* published in the Arizona Law Review, 49 Ariz. L. Rev. 297 (2007), Commissioner Mayes discussed the Commission's preference for integrated water and wastewater providers, stating:

In recent months, the Commission has issued decisions indicating a preference that new subdivisions be served, where possible, by integrated water and wastewater companies. These integrated utilities help to achieve economies of scale, encourage conservation efforts, and facilitate the use of effluent for golf course irrigation, ornamental lakes, and other water features. The concept of integrated wastewater and water companies was approved by the 1999 Commission Water Task Force, a working group comprised of Commission Staff, the Residential Utility Consumer Office ("RUCO"), ADEQ, ADWR, and water company stakeholders. Though the Task Force's policy proposals have never been formally adopted by the Commission, the integrated water and wastewater model has been explicitly favored in several recent decisions.

Companies competing for the right to serve some of the state's fastest growing areas are advantaged when they present an integrated approach to the Commission, thus allowing Commissioners the opportunity to mandate the use

of effluent from the moment the service area is created.
(footnotes omitted).

Commissioner Mayes discussed one such case in her article:

In Woodruff, the Commission was presented with a choice between two water companies that wanted to serve the same 3,200 acre development (called Sandia) in a fast growing area of Pinal County. The Commission's decision was heavily influenced by the question of whether the CC&N should be granted to an entity capable of utilizing effluent. Ultimately, the Commission awarded the CC&N to Woodruff Water and Sewer Companies over AWC. The Commission chose Woodruff despite the fact [that] AWC was a far more experienced water provider. The Commission favored Woodruff's planned use of effluent from its planned wastewater treatment facility to sustain the development's proposed golf course. During the CC&N hearing, Woodruff testified that its integrated approach to wastewater and water was designed to facilitate a 20-year build-out of the development, and that it would allow it to implement a water reuse program that it called "essential" to the project. Against this backdrop, the Commission concluded that "[t]he benefits of developing and operating integrated water and wastewater utilities in this instance outweigh the economies imputed to AWC's larger scale." (footnotes omitted).

From these statements and the proposed rule revisions in the Rulemaking, it is clear that the Commission is very interested in the public policy of integrated water and wastewater providers. An evaluation of the opportunity for integration of water and wastewater services in this remand proceeding is entirely consistent with "the overall public interest underlying service to the Cornman property" as set forth in Decision 69722.⁷

A copy of Chairman Mayes' law review article is attached hereto as Exhibit A.

Additionally, in Mr. Hendricks' direct testimony on behalf of Cornman Tweedy, he describes the operational benefits that integrated water and wastewater systems provide as compared to stand-alone water systems such as AWC's system. These operational benefits include the following:

⁷ Rebuttal Testimony of Jim Poulos dated February 5, 2008 ("Poulos Rebuttal") at page 7, line 12 through page 10, line 10.

- Integration enables the water provider to assist the sewer provider in collecting past due balances;
- Integration promotes the public policy of managing groundwater, a precious resource;
- Integration provides greater flexibility in designing treatment systems and addressing waste streams which promotes more cost-effective compliance with environmental standards;
- Integration provides enhanced security;
- Integration improves customer convenience by providing one-stop shopping;
- Integration and consolidation create efficiencies;
- Integrated systems save money in the design and construction phases; and
- Integrated systems are less expensive to operate.⁸

Mr. Hendricks, an expert in water and wastewater systems with decades of experience,⁹ concluded his testimony by stating:

Based upon my experience and involvement with respect to both integrated and stand-alone water and wastewater systems, as well as for the reasons described in my testimony above, given a choice, an integrated water and wastewater provider is always preferable to two separate stand-alone providers and should be encouraged whenever possible.¹⁰

The evidence presented by Cornman Tweedy regarding integration is completely consistent with the public interest considerations expressed by Chairman Mayes and the Commission as described above. Given (i) Cornman Tweedy's objection to having its property included in the CC&N of a water provider that is not an integrated provider, and (ii) the lack of a need and necessity for water service (as discussed below), there is no compelling reason whatsoever for the Cornman Tweedy Property to be included in AWC's CC&N at this time. Rather, at such time as the Cornman Tweedy Property is developed and there is a demonstrated need and necessity for service, the Commission

⁸ Direct Testimony of Paul S. Hendricks dated January 4, 2009, at page 4, line 14 through page 15, line 9.

⁹ *Id.* at page 1, lines 7-22.

¹⁰ *Id.* at page 15, lines 6-9.

1 will have "the opportunity to consider the overall best interests of the Cornman area and
2 of the public" consistent with the Decision.

3 **IV. THERE IS NO CURRENT NEED AND NECESSITY FOR WATER**
4 **SERVICE FOR THE CORNMAN TWEEDY PROPERTY.**

5 The Commission asked the parties to address whether there is a current need and
6 necessity for water service for the Cornman Tweedy Property. Without any doubt, there
7 is not. Mr. Poulos testified:

8 [T]he business plan for the EJR Ranch Property changed 180 degrees
9 since December 2004. Cornman Tweedy purchased the EJR Ranch
10 property with the plan of developing the property in a strong real estate
11 market, and Robson commenced the process of entitling the property.
12 However, Robson did not anticipate the tremendous appreciation in the
13 value of the property which occurred after the acquisition, nor did Robson
14 anticipate the dramatic decline in the demand for new residential housing
15 which commenced in late 2005 and continues today. As a result of these
16 changed circumstances, Robson ceased further development activities
17 except for certain pending entitlement activities that could be
18 expeditiously completed. Robson has no plans to develop the EJR Ranch
19 property. The property has been indefinitely shelved. There is no need
20 and necessity for water service.¹¹

21 This evidence is uncontroverted. Nowhere in the AWC Direct or Rebuttal
22 testimonies does AWC assert that there is a need and necessity for water service for the
23 Cornman Tweedy Property. Although in his Direct Testimony, Mr. Garfield stated that
24 he did not agree with Mr. Poulos that the Commission granted a CC&N to AWC where
25 there is no current need for water service, his primary argument is:

26 The Commission does not require that there be a request for service in
27 every portion of a CCN extension area before approving a CCN extension.
28 In Decision No. 66893, the Commission expressly found that there was a
public need and necessity for water service in the CCN extension area,
which includes what is now the Cornman Tweedy property. Cornman
Tweedy never objected to Arizona Water Company's CCN extension
before the Commission granted it.¹²

¹¹ Direct Testimony of Jim Poulos dated January 4, 2008 ("Poulos Direct") at page 10, lines 15-26.

¹² Rebuttal Testimony of William M. Garfield dated January 4, 2008 at page 3, lines 23-26, page 4 lines 1-2.

Mr. Garfield's assertion that Cornman Tweedy never objected to the inclusion of the Cornman Tweedy Property in AWC's CC&N is misleading and false. Soon after Cornman Tweedy acquired the property (which was after Decision 66893 was issued on April 6, 2004), it notified the Commission of its objection to the inclusion of the Cornman Tweedy Property in AWC's CC&N, and has continued steadfastly to object throughout the period of time that the extension of the compliance deadline was being pursued by AWC.¹³ Regardless, this issue is not relevant in addressing whether there is a current need and necessity for water service to the Cornman Tweedy Property—which the uncontroverted evidence demonstrates there is not. Mr. Garfield ignores the express language in the Decision which states that because there may not be a current need or necessity for water service for the Cornman Tweedy Property, deletion of the Cornman Tweedy Property from the AWC CC&N may be appropriate. Specifically, the Commission put AWC on notice that because of changed circumstances, as well as the broader public interest considerations for the area, exclusion of the Cornman Tweedy Property may be warranted. For all of the reasons set forth in this brief, the Cornman Tweedy Property should be excluded from AWC's CC&N.

V. **CORNMAN TWEEDY DOES NOT WISH TO HAVE ITS PROPERTY INCLUDED IN AWC'S CC&N AND THERE IS NO REQUEST FOR UTILITY SERVICE FOR THE CORNMAN TWEEDY PROPERTY.**

Cornman Tweedy does not wish to have its property included in AWC's CC&N and there is no request for water service for the Cornman Tweedy Property. These facts are: (i) not in dispute between the parties; (ii) recognized by the Commission in the express language of the Decision; and (iii) two of the very reasons the Commission ordered the Remand Proceeding. On August 12, 2003, AWC filed its application with the Commission to extend its CC&N to include the 240-acre parcel included in Florence Country Estates that was subsequently acquired by Cornman Tweedy on December 8, 2004.¹⁴ The prior owner of another 649 acres that Cornman Tweedy acquired, the

¹³ Poulos Direct at page 7, lines 16-27; see also page 8, lines 2-8.

¹⁴ Poulos Direct at page 6, lines 15-22.

1 Dermer Family Trust, had also docketed a letter on April 21, 2004, stating that it was not
2 aware of AWC's application, that it did not receive notice of the application, and that it
3 did not want its property included in AWC's CC&N.¹⁵ Cornman Tweedy also acquired
4 other property within the Conditional Extension Area which, when combined with the
5 Florence Country Estates property, totals approximately 1,138 acres which comprises the
6 Cornman Tweedy Property.¹⁶ On April 7, 2005, Cornman Tweedy filed a letter with the
7 Commission stating that Cornman Tweedy did not wish to have its property included in
8 AWC's CC&N, that Cornman Tweedy would prefer to receive water and wastewater
9 services from its affiliates, Picacho Water Company and Picacho Sewer Company, for
10 reasons of cost, convenience, timing, avoidance of confusion and avoidance of
11 unnecessary duplication of facilities.¹⁷

12 For more than four years now, Cornman Tweedy has assiduously and consistently
13 taken the position in this docket that its property should not be included in AWC's
14 CC&N. Moreover, Cornman Tweedy believes it is not good public policy to allow a
15 water provider to hold a CC&N for property where the property owner has not requested
16 water service. When asked if Cornman Tweedy has ever requested water service from
17 AWC, Mr. Poulos testified:

18 No. In fact since April 2005, Cornman Tweedy has been working to get the
19 Cornman Tweedy Property excluded from AWC's CC&N. Before that, the
20 Dermer Trust (to which Cornman Tweedy is a successor) began working to
21 get its property excluded from AWC's CC&N in April 2004. This case
22 does not only involve a lack of a request for service, but also involves
affirmative and relentless efforts to get the Cornman Tweedy Property
excluded from AWC's CC&N.¹⁸ (emphasis added).

23 This is another of the public interest reasons why the Commission should exclude
24 the Cornman Tweedy Property from AWC's CC&N. The Commission should always
25 consider the wishes of the property owner as one of the relevant public interest factors
26

27 ¹⁵ *Id.* at page 7, line 28 through page 8, line 8.

¹⁶ *Id.* at lines 24-26.

¹⁷ *Id.* at page 7, lines 17-27.

28 ¹⁸ *Id.* at page 13, lines 19-25.

1 when making decisions regarding CC&Ns, and should require that there be a *bona fide*
2 request for service from the affected property owner for the reasons further discussed
3 below.

4 **VI. THE OVERALL PUBLIC INTEREST IS NOT SERVED BY AWC**
5 **CONTINUING TO HOLD A CC&N FOR THE CORNMAN TWEEDY**
6 **PROPERTY.**

7 The Arizona Supreme Court has held that the “public interest is the controlling
8 factor in decisions concerning service of water by water companies.”¹⁹ Cornman Tweedy
9 has presented evidence identifying a number of compelling reasons why it would not be
10 good public policy to permit AWC to continue to hold the CC&N for the Cornman
11 Tweedy Property, and has presented evidence in this case addressing each of these public
12 policy considerations as they are all present in the instant case. They include:

- 13 • The premature grant of a CC&N without a request for service will
14 often contradict the desires of the landowner, especially where the
15 property is being assembled over time for inclusion in a master-
16 planned development, which is the ultimate plan for the Cornman
17 Tweedy Property;²⁰
- 18 • It can lead to a situation where, such as in this case, a single
19 development is potentially split between two water providers;²¹
- 20 • It can foreclose desirable options for the landowner such as selecting
21 an integrated water and wastewater provider. AWC is not an
22 integrated water and wastewater provider and Cornman Tweedy
23 would prefer service from an integrated provider;²²
- 24 • It prevents the premature foreclosure of the full range of options that
25 may be considered by the Commission;²³ and
- 26 • The Commission now routinely denies applications for new CC&Ns
27 and extensions of existing CC&Ns where there is no request for
28

25 ¹⁹ *James P. Paul Water Company v. Arizona Corporation Commission*, 137 Ariz. 426, 429, 671 P.2d 404,
26 407.

26 ²⁰ Poulos Direct at page 14, lines 4-7.

27 ²¹ *Id.* at lines 7-9; see also Direct Testimony of Fred E. Goldman, page 3, line 16 through page 4, line 23.

27 ²² *Id.* at lines 10-11; see also Direct Testimony of Paul S. Hendricks at page 4, line 14 through page 15,
28 line 9.

28 ²³ *Id.* at lines 12-15.

1 service and has recently amended its regulations to require proof that
2 service has been requested.²⁴

3 The pre-filed direct and rebuttal testimonies and exhibits presented by Cornman
4 Tweedy go directly to the public interest considerations applicable to whether AWC
5 should continue to hold the CC&N for the Cornman Tweedy Property and should be
6 considered and weighed by the Commission in this case. Specifically, the Cornman
7 Tweedy witnesses have presented evidence relating to the lack of a need and necessity
8 for service, the negative effects of splitting a development between two providers, the
9 cost-benefit and resource analysis of integrating water and wastewater service versus
10 stand-alone water providers, and other recent and important policy initiatives of the
11 Commission. Moreover, there has been no development (nor will there be any
12 development in the foreseeable future) of the Cornman Tweedy Property, and AWC will
13 not be prejudiced or harmed in any way by the exclusion of this relatively small number
14 of acres from its CC&N.²⁵ In fact, AWC will still have an opportunity to apply to serve
15 the Cornman Tweedy Property in the future when and if service is requested.

16 Finally, because circumstances have materially changed since the Commission
17 initially and conditionally issued the CC&N to AWC for the Cornman Tweedy Property,
18 the Commission is entitled to take such changed circumstances into consideration in this
19 Remand Proceeding. In his Rebuttal Testimony, Assistant Director Steve Olea testified
20 that he did not have anything to add to his testimony from the July 10, 2006, hearing in
21 this matter.²⁶ Although that particular testimony related to whether the compliance
22 deadline should be extended for the AWC conditional CC&N, Mr. Olea addressed how
23 Staff looks at changed circumstances following the initial grant of a conditional CC&N.
24 This is clearly analogous to the instant situation where the Commission expressly
25 ordered the Remand Proceeding on the basis of the changed circumstances relating to the

26
27 ²⁴ *Id.* at lines 16-28.

28 ²⁵ See discussion in Rebuttal Testimony of Fred Goldman dated February 5, 2008 at page 1 line 14 through page 2, line 28.

²⁶ Rebuttal Testimony of Steve Olea dated January 18, 2008 at page 2, lines 1-3.

Cornman Tweedy Property since the issuance of the conditional CC&N. At the July 10, 2006 hearing, counsel for AWC asked Mr. Olea the following question:

Hirsch: [W]ouldn't it be Staff's position that as long as the utility is doing everything reasonably within its power to comply that it would be appropriate to grant a continuance?

Olea: And that if none of the circumstances had changed from the time the original CC&N was issued.

And in that memo we stated because of the changed circumstances, there was a new property owner that was now objecting to the time extension, and not just the time extension but to being served by Arizona Water, that based on that Staff believed that this should go back to an evidentiary hearing to determine if the time extension should be granted.²⁷

Mr. Olea clearly recognized that even after the issuance of a CC&N, Staff would consider changed circumstances including the fact that there was a new property owner that was objecting because it did not want to be included in the CC&N. Cornman Tweedy submits that these changed circumstances are important public policy considerations to be taken into consideration in this Remand Proceeding in accordance with the express language in the Decision.

In this case, there are at least five material changes in circumstances that from a public policy standpoint warrant the exclusion of the Cornman Tweedy Property from AWC's CC&N:

- Since the issuance of Decision 66893 in 2004, Cornman Tweedy acquired the contiguous tract of 1,138 acres within the Conditional Extension Area which is part of a larger 2,344-acre tract that may one day be developed as the EJR Ranch master planned development. Cornman Tweedy did not have an opportunity to participate in this case prior to the Commission's approval of Decision 66893.²⁸
- The prior owners of the 240-acre Florence Country Estates property initially requested water service from AWC, but Cornman Tweedy opposed water service from AWC. The balance of the 1,138-acre

²⁷ Transcript of Hearing Dated July 10, 2006, Vol. II at 322, lines 9-24 (emphasis added).

²⁸ *Closing Brief of Cornman Tweedy 560, LLC* dated September 15, 2006, at page 6 lines 25-28 through page 7, lines 1-2; See also Poulos Direct, page 6-lines 15 through page 8, line 8.

Cornman Tweedy Property never made a request for water service to AWC.²⁹

- While the prior owners of the 240-acre Florence Country Estates property had plans to develop the property, Cornman Tweedy never intended to use those plans and, in fact, has indefinitely shelved plans to develop EJ Ranch (including the former Florence Country Estates property) because of the severe downturn in the real estate market and the economy.³⁰
- Since issuance of Decision 66893, Picacho Water Company obtained a CC&N extension in Decision 67670 (March 9, 2005) to provide water service in the southern half of EJ Ranch, which is contiguous to the Cornman Tweedy Property, and could serve the Cornman Tweedy Property in the future upon receipt of a request for service and approval by the Commission. Decision 67670 also granted a CC&N extension to Picacho Sewer Company for all of EJ Ranch, including the 1,138-acre Cornman Tweedy Property.³¹ Therefore, the Cornman Tweedy Property could be served in the future by an integrated water and wastewater provider which was not an option at the time the Commission issued Decision 66893. AWC is not an integrated provider.
- The Commission no longer grants CC&Ns to water providers without a request for service from the property owner.³²

None of the above-cited changed circumstances can be controverted by AWC.

VII. THE ISSUES TO BE DETERMINED IN THE REMAND PROCEEDING ARE NOT AS NARROW AS AWC SUGGESTS.

The Decision makes clear that the Commission ordered a remand proceeding "broad in scope" to examine the public interest surrounding whether or not the Cornman Tweedy Property should be excluded from AWC's CC&N. Cornman Tweedy has outlined and discussed the relevant considerations in this brief. However, in direct contradiction of the plain language of the Decision, AWC has asserted the position through Mr. Garfield that there is only one issue for this Remand Proceeding:

²⁹ *Id.* at page 7, lines 3-5; *see also* Poulos Direct at page 6-lines 15 through page 8, line 8.

³⁰ *Id.* at lines 6-9; *see also* Poulos Direct at page 10, lines 15-26.

³¹ *Id.* at lines 10-15; *see also* Commission Decision No. 67670 (March 9, 2005).

³² Poulos Direct at page 14, lines 16-28.

[T]he only remaining issue for the Commission to decide in this proceeding is whether any party can prove by clear and convincing evidence that Arizona Water Company is no longer a fit and proper entity to provide water utility service in the Cornman Tweedy property in the company's CCN area that is now unconditionally part of Arizona Water Company's CCN pursuant to Decision No. 69722.³³

Mr. Poulos correctly highlights the fallacy of this statement in his Rebuttal Testimony, wherein he states:

Mr. Garfield's statement of the issue in his pre-filed testimony is nonsensical and attempts to improperly narrow the scope of this remand proceeding. The Commission just ruled in Decision 69722 that AWC is fit and proper to provide water service to the extension area. Decision 69722 at 20, Conclusion of Law 3. Thus, there is no reason the Commission would remand this case on that issue. Rather, the Commission remanded the case to develop a complete record around: (i) whether there is a current need and necessity for water service at the property owned by Cornman Tweedy; and (ii) the reasons Cornman Tweedy does not want its property included in AWC's Certificate of Convenience and Necessity ("CC&N"). Further, the Commission ordered that this remand proceeding be "broad in scope so the Commission may develop a record to consider *the overall public interest underlying service to the Cornman property.*" (Decision 69722 at 20, ¶104, lines 4-5) (emphasis added).³⁴

Accordingly, AWC's misguided attempt to improperly narrow the scope of this Remand Proceeding should be rejected and the express wishes of the Commission, as outlined in the Decision, should be followed.³⁵

VIII. CONCLUSION.

The evidence presented by Cornman Tweedy in this Remand Proceeding clearly demonstrates that:

³³ Garfield Direct at page 3, lines 23-28.

³⁴ Poulos Rebuttal at page 2, line 22 through page 3, line 6.

³⁵ Cornman Tweedy incorporates by reference the legal analysis and arguments set forth in its *Response to AWC'S Motion to Strike and Pre-Hearing Brief on Legal Issues* filed on February 15, 2008, regarding the appropriate legal standard to be applied in the instant case.

1. The public interest is best served by a Commission preference for the multiple benefits of integrated water and wastewater providers over the limitations of stand-alone water providers;
2. There is no current need and necessity for water service for the Cornman Tweedy Property;
3. Cornman Tweedy does not wish to have its property included in AWC's CC&N and there is no request for utility service for the Cornman Tweedy property; and
4. The overall public interest is served by excluding the Cornman Tweedy Property from AWC's CC&N at this time.

There has been no development (nor will there be any development in the foreseeable future) of the Cornman Tweedy Property, and AWC will not be prejudiced or harmed in any way by the deletion of this relatively small number of acres from its CC&N. Moreover, AWC will have an opportunity to apply to serve the Cornman Tweedy Property in the future when and if service is requested. Finally, given that it will be many years before the Cornman Tweedy Property is developed, the public interest is better served by allowing the Commission to retain the ability to grant the water CC&N to the provider which is best suited to provide such service at the time service is requested by the property owner.

For all of the foregoing reasons, Cornman Tweedy requests that, pursuant to A.R.S. §40-252, the Commission modify the Decision to exclude the Cornman Tweedy Property from AWC's CC&N.

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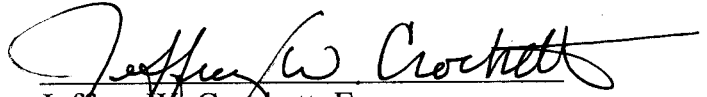
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1 RESPECTFULLY submitted this 15th day of May, 2009.

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EXHIBIT A

ENCOURAGING CONSERVATION BY ARIZONA'S PRIVATE WATER COMPANIES: A NEW ERA OF REGULATION BY THE ARIZONA CORPORATION COMMISSION

Kris Mayes*

I. THE ARIZONA CORPORATION COMMISSION: AN INTRODUCTION

A. *Private Water Companies and Growth: Managing Complexity*

The Arizona Corporation Commission ("Commission") has both constitutional and statutory authority to regulate Arizona's public service corporations, including the approximately 350 private water companies currently serving an estimated 400,000 customers in the state.¹ Article 15, section 2, of the Arizona Constitution specifically mandates that water companies are to be among those shepherded by the Commission.²

With as many as 12,000 people moving to Arizona each month—9,400 per month to Maricopa County alone—ensuring the long-term availability of water

* Arizona Corporation Commissioner. This Article is a revised version of a paper originally presented at the Water Law and Policy Conference hosted by the University of Arizona James E. Rogers College of Law in Tucson, Arizona, on October 6–7, 2006. Articles from the Conference are collected in this symposium issue, Volume 49 Number 2, of the *Arizona Law Review*.

1. Interview with Commission Staff, including Steve Olea, Assistant Dir., Utils. Div., Ariz. Corp. Comm'n, in Phoenix, Ariz. (Oct. 2005).

2. The Arizona Constitution defines "public service corporations" as follows:
All corporations other than municipal engaged in furnishing gas, oil or electricity for light fuel or power; or in furnishing water for irrigation, fire protection, or other public purposes; or in furnishing, for profit, hot or cold air or steam for heating or cooling purposes; or engaged in collecting transporting, treating, purifying and disposing of sewage through a system, for profit; or in transmitting messages or in furnishing public telegraph or telephone service, and all corporations other than municipal, operating as common carriers, shall be deemed public service corporations.

ARIZ. CONST. art. 15, § 2.

for all residents has become increasingly important.³ The Commission uses a number of tools to encourage or mandate water conservation. These tools include the use of Orders Preliminary for water companies outside an Active Management Area to require that companies prove up adequate water supplies prior to receiving a Certificate of Convenience and Necessity ("CC&N"); a preference for integrated wastewater and water utilities in order to maximize the potential for the use of reclaimed water in common areas, golf courses, and ornamental water features; measures to encourage the consolidation of small water companies, particularly those in growing areas prone to shortages; curtailment tariffs, now required of all water companies; tiered water rates, which are also now established in rate cases; and the use, when necessary, of hook-up moratoriums.

However, as the state struggles to match water supplies with its booming population and ensure reliable water delivery to future generations, the Commission will need to expand its efforts at conservation into uncharted areas. This will likely include allowing for recovery in rates of the costs associated with specific conservation measures that are soon to be required by the Arizona Department of Water Resources ("ADWR"); pinpointing small distressed water companies that are suffering high water loss rates or otherwise providing substandard service and utilizing rate premiums or acquisition adjustments to encourage their consolidation into larger entities; and working more closely with executive branch agencies to facilitate the aggressive institution of conservation measures at all of the state's private water systems. The combination of a broad network of water companies under its watch and the growing demands on Arizona's water supplies requires creative oversight by the Commission. In the face of such complexity, the Commission should continue to use its plenary powers as the regulator of private water companies to mitigate the effects of growth on water supplies and to help ensure the long-term availability of Arizona's most precious resource.

B. A Brief History of the Commission's Broad Mandate

Established at statehood as a popularly elected branch of state government, the Commission was originally composed of three commissioners. It was expanded by popular vote to five commissioners in 2000. The Commission was intended by the state's founding fathers to be a bulwark for consumers against the power of the large corporations that dominated commerce at the turn of the century.⁴

In addressing various challenges to the Commission's authority, courts have largely upheld the Commission's jurisdiction over public service corporations. The courts most often note the Commission's broad powers as suggested by the language of the primary constitutional provision, article 15, section 3, of the Arizona Constitution:

3. See Jon Kamman, *County Gained 313 People a Day Since 2000*, ARIZ. REPUBLIC, June 27, 2006, at B1.

4. See THE RECORDS OF THE CONSTITUTIONAL CONVENTION OF 1910, at 614, 970 (John S. Goff ed., 1991); *Ariz. Corp. Comm'n v. Woods*, 830 P.2d 807, 811-13 (Ariz. 1992) (detailing the constitutional origins of the Commission).

The Corporation Commission shall have full power to, and shall, prescribe . . . just and reasonable rates and charges to be made and collected, by public service corporations within the State for service rendered therein, and make reasonable rules, regulations, and orders, by which such corporations shall be governed in the transaction of business within the State, and may prescribe the forms and contracts and the systems of keeping accounts to be used by such corporations in transacting such business, and make and enforce reasonable rules, regulations, and orders for the convenience, comfort, and safety, and the preservation of the health, of the employees and patrons of such corporations⁵

Two years after enactment of the constitution, the Arizona Supreme Court distinguished the Commission from other commissions nationally: "Article 15 of our Constitution is unique in that no other state has given its Commission, by whatever name called, so extensive power and jurisdiction."⁶ The court called the Commission's responsibility for supervising public service corporations "one of the most vexatious as well as vital questions of government" and noted that it was created by the state's founding fathers "primarily for the interest of the consumer."⁷ In short, the court ruled that the Arizona Legislature could not infringe on the Commission's exclusive powers to regulate public service corporations; it could only legislate to broaden its powers.

A later line of cases, beginning with *Arizona Corp. Commission v. Pacific Greyhound Lines*,⁸ questioned the breadth of the Commission's authority and "apparently established"⁹ the doctrine that the Commission's exclusive constitutional authority is limited to ratemaking. However, the Arizona Supreme Court, in *Arizona Corp. Commission v. State ex rel. Woods*, criticized the *Greyhound* court's narrow construction of the Commission's authority to regulate public service corporations.¹⁰ In this decision, the court noted that *Pacific Greyhound's* interpretation of article 15, section 3 was unreasonably narrow in light of "the framers' vision of the Commission's role" as well as earlier case law.¹¹ The court, however, declined to overrule *Pacific Greyhound*, noting that even a restrictive interpretation of article 15, section 3 extends the Commission's authority beyond simple ratemaking to actions that are required to complete its ratemaking responsibilities.¹² Constricting the scope of the Commission's authority, according to the *Woods* court, would frustrate the framers' intent in

5. *E.g., Woods*, 830 P.2d at 812; *State v. Tucson Gas, Elec. Light & Power Co.*, 138 P. 781, 783-84 (Ariz. 1914).

6. *Tucson Gas*, 138 P. at 783.

7. *Id.* at 786.

8. 94 P.2d 443, 450 (Ariz. 1939); *see also Rural/Metro Corp. v. Ariz. Corp. Comm'n*, 629 P.2d 83, 85 (Ariz. 1981) (in banc) (finding that the legislature's ability to expand the Commission's authority is limited to the public service corporations delineated in article 15, section 2, of the Arizona Constitution).

9. *Woods*, 830 P.2d at 815 & n.8 (noting that the language in the *Greyhound* opinion is "less than clear").

10. *Woods*, 830 P.2d at 813-15, 818.

11. *Id.* at 813-15.

12. *Id.* at 815.

forming the Commission. Today, the Commission continues to issue decisions that are rooted in the broad language of the constitution and in the spirit of *Woods* and other early cases affirming its position as the exclusive regulator of public service corporations in Arizona.¹³

II. ORDERS PRELIMINARY

A. Recognizing the Problem

As existing private water companies seek to expand their boundaries to accommodate new customers and new water companies sprout up in rural Arizona and on the periphery of the state's urban centers, the Commission is facing new questions about how to license these companies. The Commission's practice of issuing conditional CC&Ns as the primary vehicle for approving new companies and expansions is evolving to meet the new challenges posed by growth, in particular its consequences for conservation and water supplies.¹⁴

For decades, the Commission issued conditional CC&Ns, granting the CC&N but imposing a series of requirements designed to be subsequently met by the water company.¹⁵ Developers generally favor this form of CC&N because it allows them to proceed with construction and implementation of their project while the water company making the application for the CC&N works on fulfilling the conditions.¹⁶ The fundamental difference between an Order Preliminary and a conditional CC&N is that under the conditional CC&N, developers may commence construction of homes and a water system designed to deliver services to residents, whereas under the Order Preliminary regime, a developer could not begin building either homes or the water system until he had met all of the conditions outlined in the Order Preliminary and then been granted a final CC&N by the Commission. As noted above, the Commission is beginning to question the usefulness of the conditional CC&N, at least in cases involving water companies

13. Observers of the Commission have also argued for a continued expansive reading of the body's authority and reach. E.g., Deborah Scott Engelby, Comment, *The Corporation Commission, Preserving Its Independence*, 20 ARIZ. ST. L.J. 241 (1988). Scott Engelby argues that *Rural/Metro* failed to take into account the constitution's framers' "intent to encompass the entire field of public utilities." *Id.* at 259. She contends that the Commission should be permitted to determine on a case-by-case basis which new technologies and forms of utilities should be brought under its regulatory umbrella. *Id.*

14. In the case of water companies, a CC&N is essentially a grant of authority by the Commission to do business as a monopoly water company. CC&Ns are provided for by statute. ARIZ. REV. STAT. ANN. § 40-281 (2006). Section 281 permits the Commission to issue a CC&N authorizing public service corporations to conduct business in Arizona; section 282(D) allows the Commission to issue Orders Preliminary authorizing public service corporations to conduct business in Arizona.

15. In some cases, water companies are given up to 24 months to fulfill the prescribed conditions.

16. Often the water company making the application for a new CC&N is owned by the developer of the subdivision or is affiliated with the developer. See, e.g., Picacho Water Co., Decision No. 69174, Docket No. W-03528A-06-0313, at 3 n.2 (Ariz. Corp. Comm'n Dec. 5, 2006); Woodruff Water Co., Decision No. 68453, Docket No. W-01445A-04-0755, at 5 & n.1 (Ariz. Corp. Comm'n Feb. 2, 2006).

outside Active Management Areas ("AMAs").¹⁷ To that end, Chairman Jeff Hatch-Miller issued a letter in February 2005 announcing that the Commission had opened a generic docket to consider replacing conditional CC&N's with Orders Preliminary.¹⁸

Orders Preliminary are a seldom-used form of CC&N authorized under statute:

If a public service corporation desires to exercise a right or privilege under a franchise or permit which it contemplates securing, but which has not yet been granted to it, the corporation may apply to the commission for an order preliminary to the issue of the certificate. The commission may make an order declaring that it will thereafter, upon application, under rules it prescribes, issue the desired certificate, upon terms and conditions it designates, after the corporation has obtained the contemplated franchise or permit or may make an order issuing a certificate on the condition that the contemplated franchise or permit is obtained and on other terms and conditions it designates. If the commission makes an order preliminary to the issuance of the certificate, upon presentation to the commission of evidence that the franchise or permit has been secured by the corporation, the commission shall issue the certificate.¹⁹

In moving toward the issuance of Orders Preliminary outside AMAs, the Commission is attempting to avoid situations where it grants a CC&N that allows a water company to begin serving customers, but later discovers that the company has failed to meet the CC&N conditions. Some of the developer's conditions are critical to a public interest standard, including obtaining a Letter of Adequate Water Supply from ADWR or an Approval to Construct from the Arizona Department of Environmental Quality ("ADEQ").²⁰ The Commission was clearly

17. See generally Ariz. Dep't of Water Res., Assured/Adequate Water, http://www.azwater.gov/WaterManagement_2005/Content/OAAWS/default.asp (last visited Mar. 9, 2007). The 1980 Groundwater Management Act created five Active Management Areas: Prescott, Pinal, Phoenix, Tucson and Santa Cruz. ARIZ. REV. STAT. ANN. §§ 45-411, -411.03. Water conservation and recharge requirements are stricter within the state's AMAs; for example, inside an AMA, developers must comply with ADWR's Assured Water Program, which requires a demonstration that a water supply to the proposed development will be physically, legally, and continuously available for the next 100 years. This showing must be made before the developer records plats or sell parcels. Outside AMAs, developers must still determine whether there is a 100-year assured water supply, but may proceed with the sale of lots and the recording of plats as long as the developer has informed the buyer of the lack of an assured water supply.

18. See Letter from Jeff Hatch-Miller, Chairman, Ariz. Corp. Comm'n, to All Interested Parties (Feb. 14, 2005), available at <http://www.azcc.gov/divisions/admin/about/Hatch-Miller-02-14-05.pdf>.

19. ARIZ. REV. STAT. ANN. § 40-282(D).

20. Under normal circumstances, before any additions can be made to the infrastructure for a public water system, the company must first get an Approval to Construct from ADEQ. For a water company located inside an AMA, before the developer can get Department of Real Estate approval to sell lots, the developer must prove to ADWR

worried that with conditional CC&Ns, it could be conveying a property right, difficult to dislodge, before the water company and associated developers had achieved the necessary approvals from other state agencies.²¹ Thus, in August 2006, after receiving only two comments during a year-long comment period,²² the Commission directed Staff to begin using Orders Preliminary as a matter of standard practice when preparing recommendations on all new CC&N applications and CC&N extensions outside AMAs.

B. Historical Context

The Commission has utilized the Order Preliminary sparingly over the past three decades. For example, Orders Preliminary were issued in cases involving the Morristown Water Company and Johnson Utilities (Decision Nos. 41802 and 67586, respectively). In the Johnson Utilities case, the Commission granted an Order Preliminary requested by Johnson Utilities which was to be used as a vehicle to assume control over the assets and service territory of the beleaguered Arizona Utility Supply and Services, L.L.C. ("AUSS").²³ In the end, Johnson Utilities had to fulfill a number of conditions before a final CC&N for the territory previously served by AUSS would be transferred to Johnson.²⁴

that it has a 100-year assured supply of water. For developments outside an AMA developers just need a letter of adequacy or inadequacy to get permission from the Department of Real Estate to sell lots.

21. See Letter from Hatch-Miller to All Interested Parties, *supra* note 18, stating: In many instances, the utility will begin serving customers in the certificated area in question without meeting one or more of the conditions. As a result, the utility is serving customers without a valid CC&N, thereby operating without the necessary permits and possibly endangering the public. In other instances, the applicant will request several extensions of time to comply with the conditions, saddling both itself and Commission Staff with unnecessary work.

22. Constellation New Energy and Strategic Energy filed comments on March 30, 2005 and Arizona Water Company filed comments on May 18, 2005. The companies wrote in support of the Commission's continuing its practice of issuing conditional CC&Ns but preventing the applicant from serving customers within the CC&N until all conditions have been fulfilled and the applicants have received a confirmation letter from the Commission. Arizona Water Company filed comments on May 18, 2005, indicating support for the continued issuance of conditional CC&Ns, with the addition of language preventing the applicant from serving customers until all conditions have been fulfilled and the applicant has received a confirmation letter from the Commission.

23. Ariz. Util. Supply & Servs., L.L.C., Decision No. 67586, Docket No. SW-04002A-02-0837, at 13 (Ariz. Corp. Comm'n Feb. 15, 2005). AUSS was a wastewater utility that filed for bankruptcy protection and experienced difficulty operating two of its treatment plants; thus, this case essentially involved one utility coming to the rescue of another. See *id.* at 5-7.

24. *Id.* at 8-9. Among the conditions that had to be met by Johnson before a final CC&N would issue were the transfer of all AUSS's franchise rights with Pinal County to Johnson, the transfer of any governmental approvals needed by AUSS to Johnson Utilities, and a series of ADEQ requirements necessary to the operation of AUSS plants and transfer of the assets.

Conversely, in *Utility Source, L.L.C.*,²⁵ the Commission acknowledged the usefulness of Orders Preliminary but nonetheless denied the request.²⁶ In its application, the water company sought two concessions from the Commission: first, a conditional CC&N for a segment of homeowners that were already being served, but without a CC&N; and, second, an Order Preliminary for a future phase of the development.²⁷ The Commission ultimately granted a conditional CC&N for the portion of the development that was already being served, but it rejected the bid for an Order Preliminary because the water company had violated title 40, section 281 of the Arizona Revised Statutes by serving customers without a CC&N.²⁸ Consequently, the Commission ruled that the water company would have to apply separately for a CC&N extension for the future development.²⁹

Perhaps the most compelling evidence of the need for Orders Preliminary comes from a case pending before the Commission out of Mohave County.³⁰ This application involves the effort of a Nevada developer to obtain a conditional CC&N for a 30,000 home development in an area outside Kingman, Arizona. The application was filed with the Commission on July 7, 2005, and subsequently received a hearing before an Administrative Law Judge. Four days prior to the Commission's scheduled vote on the Recommended Opinion and Order, the Company's attorneys filed a letter in the docket from the ADWR, which stated that the developer had not proven up adequate water supplies. Concerned about ADWR's findings and the prospect of voting on a CC&N application that had critical deficiencies, two Commissioners requested an additional evidentiary hearing as well as discovery. At the time of this writing, the Commission is conducting additional evidentiary hearings and discovery in the matter and has hosted one public comment session in Kingman to collect input from area residents. In this instance, the use of an Order Preliminary would allow the Commission to avoid a scenario in which it might approve a CC&N, only to discover later that the company failed to acquire adequate water supplies to serve the area.

While construction of a given subdivision may be delayed during the time it takes a water company to obtain the permits required by an Order Preliminary, the Commission will have upheld the public interest by ensuring that the water company in question actually has an adequate or assured water supply, an approval to construct, and the necessary county franchise permit prior to serving its customers, all factors that reduce the likelihood of forming a water company where none should be. The consequence of this policy for the internal operation of the Commission is that most, if not all, of the Recommended Opinion and Orders in cases involving new CC&N requests and CC&N extensions in areas outside AMAs will come to us in the form of an Order Preliminary. Thus, the

25. Decision No. 67446, Docket No. WS-04235A-04-0073 (Ariz. Corp. Comm'n Jan. 4, 2005).

26. *Id.* at 10–11, 25.

27. *Id.* at 10.

28. *Id.* at 20, 23–25.

29. *Id.* at 25.

30. See Perkins Mountain Util. Co., Docket Nos. W-20380A-05-0490, SW-20379A-05-0489 (Ariz. Corp. Comm'n filed July 7, 2005).

recommended Order Preliminary would be approved or denied at a Commission Open Meeting, and, after the applicant water company meets all of the pre-conditions, it would return to the Commission for a final Order granting or denying a CC&N.

III. REQUIRING WATER RE-USE AT ARIZONA'S PRIVATE WATER COMPANIES

A. Toward a New Paradigm: Integrated Water and Wastewater Systems

In recent months, the Commission has issued decisions indicating a preference that new subdivisions be served, where possible, by integrated water and wastewater companies. These integrated utilities help to achieve economies of scale, encourage conservation efforts, and facilitate the use of effluent for golf course irrigation, ornamental lakes, and other water features.³¹ The concept of integrated wastewater and water companies was approved by the 1999 Commission Water Task Force, a working group comprised of Commission Staff, the Residential Utility Consumer Office ("RUCO"), ADEQ, ADWR, and water company stakeholders. Though the Task Force's policy proposals have never been formally adopted by the Commission, the integrated water and wastewater model has been explicitly favored in several recent decisions. One of these cases involved a clash between the Arizona Water Company ("AWC"), a stand-alone water utility, and a competing entity that proposed to serve the area in question with an integrated water and wastewater operation.³²

In *Woodruff*, the Commission was presented with a choice between two water companies that wanted to serve the same 3,200 acre development (called Sandia) in a fast growing area of Pinal County.³³ The Commission's decision was heavily influenced by the question of whether the CC&N should be granted to an entity capable of utilizing effluent. Ultimately, the Commission awarded the CC&N to Woodruff Water and Sewer Companies over AWC. The Commission chose Woodruff despite the fact the AWC was a far more experienced water provider.³⁴ The Commission favored Woodruff's planned use of effluent from its

31. The following companies are integrated water and wastewater providers: Ajo Improvement Co., Baca Float Water Co., Bachmann Springs Utility Co., Clear Springs Utility Co., Cloud Nine Water Co., Far West Water and Sewer, Fisher's Landing Water and Sewer Works, Francisco Grande Utility Co., Johnson Utilities Co., MHC Operating Limited Partnership, Oak Creek Utility Co., Pima Utility Co., Rainbow Parks, Red Rock Utilities, Rio Rico Utilities, Rio Verde Utilities, Sunrise Utilities, Sunrise Vistas Utilities, Utility Source, Willow Springs Utilities, Litchfield Park Service Co., Santa Cruz Water Co., Picacho Water Co., Palo Verde Utilities, Santa Rosa Utilities, and Arizona-American Water. Arizona-American is the oldest integrated water-wastewater company in Arizona.

32. Woodruff Water Co., Decision No. 68453, Docket No. W-01445A-04-0755, at 5-6 (Ariz. Corp. Comm'n Feb. 2, 2006), *appeal filed*, ICA-CV 07-0167 (Ariz. Ct. App. Mar. 9, 2007).

33. At build-out the Sandia development will serve an estimated 25,000 to 30,000 people. *Id.* at 7.

34. *Id.* at 5, 31. AWC is a water company serving more than 80,000 customers in eight Arizona counties. Woodruff is a water company founded by a developer with no prior experience operating water companies in Arizona, though the Company did put on evidence

planned wastewater treatment facility to sustain the development's proposed golf course.³⁵ During the CC&N hearing, Woodruff testified that its integrated approach to wastewater and water was designed to facilitate a 20-year build-out of the development, and that it would allow it to implement a water reuse program that it called "essential" to the project.³⁶ Against this backdrop, the Commission concluded that "[t]he benefits of developing and operating integrated water and wastewater utilities in this instance outweigh the economies imputed to AWC's larger scale."³⁷

Companies competing for the right to serve some of the state's fastest growing areas are advantaged when they present an integrated approach to the Commission, thus allowing Commissioners the opportunity to mandate the use of effluent from the moment the service area is created.

B. Mandating Effluent for Use on Golf Courses and Ornamental Water Features

In recent decisions, the Commission has begun prohibiting water companies from selling groundwater for use on new golf courses or ornamental water features.³⁸ This effectively means that developers hoping to construct golf courses and ornamental water features within the service territories of water companies subject to this provision will either have to find the effluent for use on their golf courses, or wait to build the golf course until the development is

that it had hired an individual with significant experience running a separate water and wastewater company serving master planned developments in Arizona. *Id.* at 5.

35. *See id.* at 29.

36. *See id.* at 8. During the Commission's Open Meeting on the matter, the company's attorney told the Commissioners that the developer, which was owned by the same individual as the proposed water company, had agreed to voluntarily postpone construction of two golf courses until such time as effluent was made available from build-out of second phase of the development. The Author believes *Woodruff* to be a critical case in the evolution of the Commission's decision making in this area. Woodruff was the first company to concede that it was possible to defer the construction of a golf course until it had adequate build-out of homes to provide the effluent needed for the golf course. Additionally, the Author of this Article offered an amendment to the Administrative Law Judge's Recommended Opinion and Order, which was approved, requiring Woodruff to file with the Commission within a year a report detailing the company's progress in the utilization of effluent on ornamental lakes, golf courses and other aesthetic features.

37. *Id.* at 29.

38. Commission orders now routinely contain the following language:

In recent months, the Commission has become increasingly concerned about the prolonged drought in Central Arizona. Therefore, we believe [the company] should be required to conserve groundwater and that [the company] should be prohibited from selling groundwater for the purpose of irrigating any future golf courses within the certificated expansion areas or any ornamental lakes or water features located in the common areas of the proposed new developments within the certificated expansion areas.

E.g., Ariz. Water Co., Decision No. 69163, Docket No. W-01445A-06-0059, at 10 (Ariz. Corp. Comm'n Dec. 5, 2006).

sufficiently built out to provide the effluent.³⁹ Two water companies have objected to this provision, arguing that it veers into regulatory territory already occupied by ADWR. The opponents of the effluent provision assert that ADWR has promulgated rules under its Third Management Plan that allow the use of some groundwater on golf courses inside AMAs, and that therefore the Commission prohibition goes too far.⁴⁰ The Commission retained the language over the Company's objections in both instances.⁴¹ The Commission should continue its recently established practice of prohibiting groundwater for use on golf courses and ornamental water features in order to achieve the state's conservation goals.

C. Aggressive Water Reuse by Newly Formed Water Companies: The Global Water Resources Example

While it has become commonplace for wastewater utilities to deliver effluent for use on golf courses, greenbelts, ornamental lakes, and other ornamental water features (and for the Commission to require these uses as a condition to a new CC&N) no Arizona water or wastewater company has yet provided effluent for outdoor or indoor residential use. One Arizona water company, however, has announced plans to begin the aggressive use of effluent at the home-site. Global Water Resources recently briefed Corporation Commissioners on the company's decision to take effluent to home-sites within the Belmont development in western Maricopa County, a 25,000 acre residential

39. To date, the language prohibiting the use of groundwater on new golf courses has been adopted in twelve cases: Empirita Water Co., Decision No. 69399, Docket No. W-03948A-06-0490, at 13 (Ariz. Corp. Comm'n Mar. 29, 2007); Ariz. Water Co., Decision No. 69386, Docket No. W-01445A-06-0317, at 14 (Ariz. Corp. Comm'n Mar. 22, 2007); Lucky Hills Water Co., Decision No. 69381, Docket No. W-01961A-06-0037, at 8 (Ariz. Corp. Comm'n Mar. 22, 2007); Green Acres Water, L.L.C., Decision No. 69256, Docket No. W-20430A-05-0839, at 18 (Ariz. Corp. Comm'n Jan. 19, 2007); Beaver Dam Water Co., Decision No. 69243, Docket No. W-03067A-06-0117, at 7 (Ariz. Corp. Comm'n Jan. 19, 2007); Diablo Village Water Co., Decision No. 69206, Docket No. W-02309A-05-0501, at 11 (Ariz. Corp. Comm'n Dec. 21, 2006); Picacho Water Co., Decision No. 69174, Docket No. W-03528A-06-0313, at 7 (Ariz. Corp. Comm'n Dec. 5, 2006); Ariz. Water Co., Decision No. 69163, Docket No. W-01445A-06-0059, at 10 (Ariz. Corp. Comm'n Dec. 5, 2006); Willow Springs Utils., L.L.C., Decision No. 68963, Docket No. WS-20432A-05-0874, at 16 (Ariz. Corp. Comm'n Sept. 21, 2006); Johnson Utils. Co., Decision No. 68961, Docket No. WS-02987A-05-0695, at 7 (Ariz. Corp. Comm'n Sept. 21, 2006); Diversified Water Utils., Inc., Decision No. 68960, Docket No. W-02859A-04-0844, at 6 (Ariz. Corp. Comm'n Sept. 21, 2006); Ariz. Water Co., Decision No. 68919, Docket No. W-01445A-05-0701, at 7 (Ariz. Corp. Comm'n Aug. 29, 2006).

40. See Arizona Water Company's Exceptions to Administrative Law Judge's Recommended Order at 5, Ariz. Water Co., Decision No. 69163, Docket No. W-01445A-06-0059 (filed Oct. 12, 2006); Exceptions of Picacho Water Company to Administrative Law Judge's Recommended Opinion and Order, Picacho Water Co., Decision No. 69174, Docket No. W-03528A-06-0313 (filed Nov. 16, 2006).

41. See Picacho Water Co., Decision No. 69174, at 7; Ariz. Water Co., Decision No. 69163, at 10.

subdivision.⁴² This subdivision will receive water from the Water Utility of Greater Tonopah and wastewater service from Hassayampa Utilities, both owned by Global.⁴³

Global is proposing using reclaimed water for all outside uses at home sites within the Belmont community. Assuming the average home usage is 0.4 acre-feet ("AF") of water, 0.16 AF for outside uses and 0.24 AF for indoor uses, the home would send 0.16 AF of discharge to treatment.⁴⁴ Under Global's Belmont proposal, the 0.16 AF of discharge would go to treatment and then be used as treated effluent to supply the outside water needs for homes within the development.⁴⁵ Basic water reclamation would result in a decrease in annual water consumption by 30%, but with the aggressive use of water reclamation annual water consumption is reduced by 40% at Belmont.⁴⁶ The neighborhood would not discharge any water, compared with a typical neighborhood, which discharges 117,288,000 gallons of water a year.⁴⁷ When the plan is complete, it is estimated that Belmont will be the largest master planned community with fully integrated water reclamation planning in Arizona.⁴⁸ The Commission should begin a process designed to examine whether provisioning of effluent for use at home sites should eventually become a requirement in future CC&N approvals, particularly in cases involving large, well-capitalized utilities.

***D. Arizona Department of Water Resources' Modified Non-Per Capita Program:
Expecting Conservation at all Water Companies***

The Commission is likely entering an era of mandating conservation measures at Arizona's regulated water companies. This is in part because ADWR is currently engaged in a stakeholder process that will culminate in the amendment of the agency's Third Management Plan, and with that amendment will come new conservation requirements for water companies.

The Third Management Plan is designed to implement the safe yield requirement established pursuant to the 1980 Groundwater Management Act. It is believed that the newly amended rules governing safe yield will require water systems, including the private water companies regulated by the Commission, to implement water conservation measures, called Best Management Practices ("BMPs"), geared toward achieving the state's safe yield target.⁴⁹ Larger water companies will likely be asked to implement more BMPs than smaller companies,

42. See Briefing to Commissioners, Trevor T. Hill, Global Water Resources LLC, Minimizing Water Use/Maximizing Water Reuse in Development (Apr. 2, 2007) (on file with author).

43. *Id.*

44. *Id.*

45. *Id.*

46. *Id.* For a typical section of land with 2,250 units, the neighborhood that consumed 293,220,000 gallons of water before reclamation and reuse would now use 175,932,000 gallons of water per year.

47. *Id.*

48. *Id.*

49. See Ariz. Dep't of Water Res., Program Framework: Modified Non-Per Capita Conservation Program (Oct. 5, 2006) (on file with author).

but all companies will be permitted to choose from a list of approximately 25 BMPs.⁵⁰ Among the list of BMPs currently under discussion are the installation or promotion of low-flush toilets or low-pressure shower heads and conservation advertising.⁵¹ In order to meet the requirements, companies will have to show that they have implemented the BMPs, but will not be required to show that the measures have resulted in a prescribed amount of conservation.⁵²

Water companies have long argued that they cannot implement conservation programs because they are unable to obtain rate relief from the Commission for their conservation efforts.⁵³ This is a fundamental misperception on the part of the companies. The Commission has never been asked for rate recovery of these programs, and Commission Staff have made it clear that they would be receptive to filings from Companies seeking to recover (in rates) the costs of implementing conservation programs, particularly those designed to satisfy ADWR's new rulemaking.⁵⁴ The Commission should continue to make it clear that it is ready to facilitate conservation efforts by water companies, especially those programs that are necessary to meet ADWR's new rules, and that the Commission is prepared to do this even before ADWR finalizes its rulemaking. Moreover, the Commission should notify water companies that they can file tariff applications with the Commission that are designed to implement conservation programs. For example, these tariffs could be designed to allow water companies to carry out conservation measures in the same way municipalities do. Such water company tariffs could condition service on the installation of low-flow toilets, low-flow shower heads, or minimal or zero usage of groundwater for outdoor irrigation. The Commission could adopt these tariffs as part of rate cases, CC&N applications or CC&N extensions.

IV. ENCOURAGING CONSOLIDATION OF DISTRESSED WATER COMPANIES AS A MEANS OF ACHIEVING WATER CONSERVATION AND REUSE

Implementation of conservation programs is generally a low priority for the state's troubled water companies. Most of these utilities lack the resources and the management experience to make conservation a priority. The only long-term hope for the advancement of conservation measures at these companies is their consolidation into other larger utilities.

In the 1999 Water Task Force Report to the Commission, Commission Staff and industry stakeholders issued a number of recommendations aimed at

50. See *id.* Under the Draft Program, water companies with up to 5,000 service connections would be required to implement a basic water conservation education program plus one other BMP; companies with between 5,001 and 30,000 service connections would be required to implement the education program plus five BMPs; and companies with more than 30,000 service connections would be required to implement the education program plus ten BMPs.

51. See *id.*

52. See *id.*

53. Interview with Commission Staff, *supra* note 1.

54. *Id.*

encouraging the consolidation of smaller water companies (Class D and E companies with Class A or B or C utilities).⁵⁵ Pursuant to section R14-2-103 of the Arizona Administrative Code, the Commission classifies public service corporations into five categories based upon the public service corporation's annual operating revenue. For water and sewer companies, the breakdown is as follows: Class A: Annual Operating Revenue exceeding \$5,000,000; Class B: Annual Operating Revenue from \$1,000,000 to \$5,000,000; Class C: Annual Operating Revenue from \$250,000 to \$999,999; Class D: Annual Operating Revenue from \$50,000 to \$249,999; Class E: Annual Operating Revenue less than \$50,000. Though each Task Force representative agreed that incentives should be used by the Commission to achieve the goal of consolidating distressed water companies, the group could not come to consensus on which incentives are best.⁵⁶ Among the consolidation incentives promoted by Staff as part of the Task Force report were rate premiums for larger water companies that acquire smaller companies, and the development of a policy or rule setting forth the Commission's parameters for acquisition adjustments—premiums on the purchase price of troubled water companies.⁵⁷ The use of an acquisition adjustment represents a fairly radical deviation from normal ratemaking processes, as it involves a decision by the Commission to allow rate base to reflect a purchase price for a company's assets that is higher than the book value of that company. Under ordinary circumstances, rates are set using the book value of a company's assets at the time they are placed in service.

Staff recommended that acquisition adjustments be used under a specific set of conditions, including where the acquisition would not be deleterious to the acquiring company; where it was in the public interest; where the purchase price was judged to be fair and reasonable; where the recovery period for the resulting acquisition adjustment was set for a definitive period of time; and where the acquisition would have a positive effect on the service of the acquired company.⁵⁸ RUCO opposed the idea of acquisition adjustments, and industry representatives argued for California's policy allowing the use of fair market value in setting acquisition adjustments.⁵⁹

Alternatively, Staff and RUCO agreed that rate premiums on the Company's authorized rate of return could be a valuable tool in the effort to encourage consolidation. Under this proposal, acquisitions would be spurred when an acquiring company realized it would be able to recover the costs of folding in a troubled company, and could do so without the regulatory lag created by the normal ratemaking process at the Commission.⁶⁰ According to RUCO, rate premiums are preferable to acquisition adjustments because they permit the

55. See WATER TASK FORCE, ARIZ. CORP. COMM'N, INTERIM REPORT OF THE ARIZONA CORPORATION COMMISSION'S WATER TASK FORCE 7-11 (1999) (Docket No. W-00000C-98-0153) (on file with author).

56. *Id.* at 8.

57. *Id.*

58. *Id.*

59. *Id.* at 8-9.

60. *Id.* at 9.

Commission to maintain control over the amount of the incentive allowed.⁶¹ Rate premiums, unlike acquisition adjustments, can be limited to a set number of years, or a specific period of time, such as the length of time between rate cases.⁶²

To date, rate premiums and acquisition adjustments have not been formally blessed by the Commission via either a rulemaking or policy statement. Since the Water Task Force report was issued, the Commission has only approved one acquisition adjustment, in a case involving the acquisition by a Class A utility of a small distressed company in southeastern Arizona.⁶³ In that case, which involved the Commission's approval of the purchase of the severely hobbled and disastrously managed McLain water systems in Cochise County, the Commission approved a \$696,000 purchase price⁶⁴ of the companies by Algonquin Water Resources of America, a multinational income fund that owns five water and wastewater companies in Arizona (excluding the McLain systems).⁶⁵ The price represented a significant inflation of the estimated book value of the companies,⁶⁶ which were believed to be in such poor shape that they represented a threat to the health and safety of the companies' customers.⁶⁷ The Commission did not refer to the purchase price as an acquisition adjustment, but that is essentially what it was, as the purchase price was substantially greater than the book value of the company. Moreover, the large purchase premium was being used by the Commission to establish a positive rate base and encourage the purchase by Algonquin.⁶⁸ The Commission acknowledged the extraordinary nature of the acquisition price and of the Commission's role in setting it, but felt it was the only hope for stimulating a purchase and rehabilitation of the companies.⁶⁹

Acquisition adjustments and rate premiums hold promise for use when the Commission desires to encourage the consolidation of small, troubled water companies. Strengthening the two dozen or so small water companies that currently find themselves on the financial ropes would dramatically improve the opportunities for implementing water conservation measures at those companies. The Commission should first endeavor to identify those water companies it believes are the likeliest targets for consolidation. A model for this has been developed in California, where the California Public Utilities Commission ("CPUC") has identified in its 2005 Water Action Plan the goal of providing incentives for the acquisition and operation of small water companies by larger

61. *Id.*

62. *Id.*

63. *See* Miracle Valley Water Co., Decision No. 68412, Docket No. W-01646A-05-0506, at 12 (Ariz. Corp. Comm'n Jan. 23, 2006).

64. *Id.* at 12.

65. *See* N. Sunrise Water Co., Decision No. 68826, Docket No. W-20453A-06-0247, at 4-5 (Ariz. Corp. Comm'n June 29, 2006).

66. *See* Minutes of the Commission Open Meeting (June 27, 2006) (on file with author). The meeting included a discussion by Commissioners regarding the dilapidated condition of the water systems; ultimately, the Commission established a purchase price that was tailored to covering the amount of taxes owed by the water companies to the State of Arizona and Cochise County, rather than to the actual value of the systems.

67. *Id.* at 8.

68. *Id.* at 9-10.

69. *Id.*

private or municipal water companies.⁷⁰ CPUC's Water Action Plan did not identify specific companies for acquisition; rather, the report identified the goal of providing incentives. CPUC Staff, working with other government agencies, has since identified thirty systems (serving 10,500 customers) that would be in a position to qualify for acquisition by larger systems.⁷¹ The Arizona Commission should similarly establish a list of troubled water systems considered candidates for consolidation and then establish a policy statement informing the water company community that acquisition adjustments and rate premiums will be considered to encourage the consolidation of these identified systems where the conditions laid out by Staff in the 1999 Water Task Force are met.⁷²

V. CORRALLING WATER LOSS: CONSERVING WATER BY KEEPING IT IN THE PIPELINE

An increasing number of Arizona's private water companies are suffering from water loss—losses that occur between the point of origin (i.e., either at a well site if groundwater is used, or the Central Arizona Canal if CAP water is used) and the point of use by customers. In determining the amount of acceptable water loss, the Commission generally follows the recommendation of the American Water Works Association that loss greater than 15% is per se unacceptable, and loss below 10% is acceptable. The Commission monitors and enforces this standard in two ways. First, each company must include as part of its annual report to the Commission an accounting of the number of gallons pumped and the number of gallons sold, which, when analyzed, offers a glimpse of the amount of water each company is losing during the distribution process. Second, each company's water loss is reviewed by Commission Staff when the company is before the Commission for a rate case or request for a CC&N extension. The Commission derives its authority to regulate water loss from its authority to establish rates that are just and reasonable.⁷³

The Commission has routinely required companies that are experiencing higher than acceptable levels of water loss to report back to the Commission with a plan to reduce loss to below the 10% standard or to explain why doing so is not

70. CAL. PUB. UTILS. COMM'N, WATER ACTION PLAN 7 (2005), available at http://www.cpuc.ca.gov/static/hottopics/3water/water_action_plan_final_12_27_05.pdf.

71. Memorandum from Michael Miller, Utils. Eng'r, Cal. Pub. Utils. Comm'n, et al. to John Bohn, Comm'r, Cal. Pub. Utils. Comm'n 1 (Oct. 23, 2006) (on file with author).

72. See WATER TASK FORCE, *supra* note 55, at 8.

73. Specifically, title 40, section 250(C) of the 2006 Arizona Revised Statutes provides:

[T]he commission shall by order establish the rates, fares, tolls, rentals, charges, classifications, contracts, practices, rules or regulations proposed, in whole or in part, or establish others in lieu thereof, which it finds just and reasonable, and which, if not suspended, shall, on the expiration of thirty days from the time of filing the order, or in such lesser time as the commission grants, become effective and be established, subject to the power of the commission to alter or modify the order.

possible. For instance, in *Livco Water Co.*,⁷⁴ Livco Water was found to have a 17.2% water loss. The Commission required Livco to file a water loss mitigation report with the Commission within 15 months of the effective date of the decision. Furthermore, the Commission ruled that Livco's water loss could not exceed 15%.⁷⁵

In the most recent rate case involving the Pine Water Company, a utility chronically beset by water shortages in the summertime, the Commission rejected a provision in the proposed Settlement Agreement that would have allowed the company to file a water loss plan designed to reduce its 12.6% water loss rate.⁷⁶ The Commission did not find the proposed water loss provision aggressive enough under the circumstances, stating:

Arizona is in a severe drought. Water is a precious resource and is in particularly limited supply in the Pine area. It is unacceptable that a utility would request that its customers pay the costs of a speculative chance for additional water but could determine that reducing existing water loss to within acceptable levels is not "practical." Pine Water's detailed water loss plan shall only address ways to reduce water loss to less than ten percent.⁷⁷

In other words, the Commission was mandating that the Company find a way to get its water loss beneath the 10% standard. The Commission further ordered its Staff to return to it with recommended actions if not satisfied by the Company's plan for remediation of the water loss problem.⁷⁸ Subsequent to this decision, Pine Water filed a detailed report looking at water supplies not only for their certificated area, but for the entire Payson area.

The Commission has also determined that some companies simply cannot come into total compliance with the water loss standard without undertaking unreasonable capital expenditures. In Decision No. 66849, the Commission determined that it would not be reasonable to require the Arizona Water Company to improve its water loss rates to below 10% on its Superior water system. The Commission found that doing so would necessitate the replacement of an above-ground pipeline that traveled significant distances and experienced evaporative losses as a result of warm temperatures.⁷⁹

74. Decision No. 68751, Docket No. W-02121A-05-0820, at 6 (Ariz. Corp. Comm'n June 5, 2006).

75. See *id.* at 6, 17.

76. Pine Water Co., Decision No. 67166, Docket No. W-03512A-03-0279, at 5-6, 15-16 (Ariz. Corp. Comm'n Aug. 10, 2004). Pursuant to the Settlement Agreement, if the Company found that reducing the 12.6% rate was infeasible or impractical, it could present its arguments against further reductions to the Commission. The Settlement Agreement also required the Company to file quarterly reports describing in detail the sources of the Company's water, quantity of water, and gallons of water pumped, whether from the Company's wells or well water obtained via well-sharing agreements, from water hauling or through the pipeline known as Project Magnolia.

77. *Id.* at 11.

78. *Id.* at 15-16.

79. See *Ariz. Water Co.*, Decision No. 66849, Docket No. W-01445A-02-0619, at 41 (Ariz. Corp. Comm'n Mar. 19, 2004).

The Commission's approach to addressing water loss suffers from its passivity. The Commission cannot know whether a company is posting high water losses unless the company comes forward and files for a rate increase or for an expansion of its territory. A random review of two water companies' annual reports illustrates that there are companies that remain out of compliance with the water loss requirement in the intervening years between rate cases. For instance, Ehrenberg Water is experiencing an 11% water loss rate and has not been in for a rate case since November, 1996. Golden Shores Water is experiencing a 16% water loss rate and has not been before the Commission since August, 1999.

The Commission's method of addressing water loss also suffers from a lack of auditing of the water loss reports. For instance, the 2003 annual report of the Beardsley Water Company (serving portions of the West Valley) claimed that it had sold five million gallons more than it pumped in 2003, suggesting a next-to-impossible net water *gain*.⁸⁰ Yet in its 2004 rate case, the Beardsley Water Company was found to have a system-wide water loss of between 2% and 3%.⁸¹

Water losses are also tracked by ADWR through the agency's Annual Water Withdrawal and Use reports, required of all water companies serving within AMAs. But these reports also go largely without audit, and appear to be often unreliable. Using the West End Water Company as an example, the Company's ADWR Annual Water Withdrawal and Use Report for 2002 declared that the Company had withdrawn 137.07 acre-feet, and delivered 126.38 acre-feet to its users, or a water loss rate of 7.8%.⁸² This contrasts with the 2002 Annual Report, filed with the Commission, in which West End Water stated that it sold 87.01 acre-feet of water, but pumped 136.18 acre-feet, for a loss rate of approximately 36%.⁸³

Staunching water losses at Arizona's water companies will require a multi-pronged effort. First, the Commission should continue on its current course requiring companies to engage in water loss mitigation planning whenever those companies come in for rate cases or CC&N extensions. Second, the Commission should consider financial incentives for companies that engage in water loss mitigation, potentially including a surcharge mechanism designed to allow for more timely recovery of costs associated with infrastructure improvements that are aimed at preventing water loss. Such a surcharge has been advocated by a coalition

80. BEARDSLEY WATER CO., ANNUAL REPORT 11 (2003), available at <http://www.azcc.gov/divisions/util/Annual%20Reports/2003/Beardsley%20Water%20Company.pdf>.

81. See ARIZ. CORP. COMM'N, STAFF REPORT: BEARDSLEY WATER COMPANY, DOCKET NO. W-02074A-04-0358: APPLICATION FOR A PERMANENT RATE INCREASE, at attachment A, at 6 (2004).

82. WEST END WATER CO., ANNUAL WATER WITHDRAWAL AND USE REPORT: PROVIDER SUMMARY 2002 (2003).

83. WEST END WATER CO., ANNUAL REPORT (2002), available at <http://www.azcc.gov/divisions/util/Annual%20Reports/2002/West%20End%20Water%20Company.pdf>.

of Arizona water companies⁸⁴ and has been implemented in other states, including Pennsylvania, Delaware, Ohio, and Illinois.⁸⁵

VI. ENCOURAGING CONSERVATION THROUGH TIERED WATER RATES AND CURTAILMENT TARIFFS

Tiered water rates and curtailment tariffs have become the de facto norm for all new water company applications, rate cases, and CC&N extensions. Beginning in 2001, Commission Staff began recommending in each water utility rate case that the Commission adopt a tiered water rate structure in order to properly price water and encourage conservation. The tiered rates are tailored specifically to each water company.

Recent Commission decisions demonstrate the use of tiered rates. In *Chaparral City Water Co.*,⁸⁶ the Commission implemented the following rate schedule:⁸⁷

Commodity Rates (per 1,000 Gallons), based upon the size of the meter going to the customer.

¾" Residential Meter

1,000–3,000 Gallons:	\$1.68
3,001–9,000 Gallons:	\$2.52
Over 9,000 Gallons:	\$3.03

¾" Commercial & Industrial Meter

1,000–9,000 Gallons:	\$2.52
Over 9,000 Gallons:	\$3.03

2" Meter (Residential, Commercial & Industrial)

From 1,000–100,000 Gallons:	\$2.52
Over 100,000 Gallons:	\$3.03

The Commission decision in Arizona Water Company's Eastern Group System⁸⁸ adopted the following rates for the Company's Bisbee system:

84. See INVESTOR OWNED WATER UTILS. OF ARIZ., RECOMMENDATIONS TO THE ARIZONA CORPORATION COMMISSION'S WATER TASK FORCE 10 (2005) (on file with author). The IOWUA white paper called on the Commission to implement a number of reforms geared toward allowing companies greater financial recovery. Among those proposals was the DSIC surcharge mechanism to permit water companies to recover funds from ratepayers between rate cases for "qualifying system improvement projects," including expenditures made by the company for "projects that reduce water losses, enhance water quality,[and] improve fire protection and long-term system viability." *Id.* at 5.

85. *Id.* at 4–5.

86. Decision No. 68176, Docket No. W-02113A-04-0616 (Ariz. Corp. Comm'n Sept. 30, 2005).

87. *Id.* at 41–42.

88. Ariz. Water Co., Decision No. 66849, Docket No. W-01445A-02-0619 (Ariz. Corp. Comm'n Mar. 19, 2004)

0 to 10,000 gallons	\$2.594
10,001 to 25,000 gallons	\$3.242
Over 25,000 gallons	\$3.89 ⁸⁹

The rates for the Company's Apache Junction System:

0 to 10,000 gallons	\$1.9688
10,001 to 25,000 gallons	\$2.4610
Over 25,000 gallons	\$2.9532 ⁹⁰

Between 2001 and 2004, the Commission began implementing curtailment plans for water companies as they filed applications at the Commission for rate cases and CC&N extensions. In May 2004, the Commission took steps to encourage every water company in Arizona to adopt a water curtailment tariff, regardless of whether they intended to come in for a rate case or CC&N extension in the near future. Originally designed to address emergencies such as a lightning strike to a well, the Commission realized that curtailment tariffs could also be used by water companies to require customers to conserve during a water shortage or severe drought conditions. Today, each water company that comes before the Commission for a rate case or CC&N extension must propose a curtailment tariff as a part of its case. If it fails to do so, Commission Staff proposes the tariff.

The Pine and Bella Vista Water Companies, serving Pine and Sierra Vista respectively, have used curtailment tariffs with regularity to address seasonal water shortages.⁹¹ At the Pine Water Company, customers have become accustomed to a curtailment regime that allows the Company to prohibit certain water uses at Stages 3, 4, and 5, dependent on water production and storage levels at the time.⁹²

The Pine curtailment tariff operates as follows:

Stage 1 (green): Water storage level is at least 90% of total capacity; no curtailment or notice required.

Stage 2 (blue): Water storage level is less than 90%, but at least 75% of capacity for at least 48 consecutive hours. Voluntary conservation measures may be employed by customers to reduce water consumption by 10%. Outside watering on weekends and holidays is curtailed. The Company is required to notify customers by changing sign postings, emailing, and posting a sign in the Pine Post Office.

Stage 3 (yellow): Water storage level is less than 75%, but at least 65% of its capacity for 24 consecutive hours. Mandatory conservation measures must be employed by customers to reduce water consumption by 25%. Outdoor watering is

89. *Id.* at 48.

90. *Id.*

91. See, e.g., Teresa McQuerrey, *Water Saving Mandated by State*, PAYSON ROUNDUP, July 15, 2005, available at <http://www.paysonroundup.com/section/localnews/story/19739>; see also Bella Vista Water Co., Decision No. 67505, Docket No. W-02465A-04-0692 (Ariz. Corp. Comm'n Jan. 20, 2005).

92. See Pine Water Co., Decision No. 65914, Docket No. W-03512A-03-0104 (Ariz. Corp. Comm'n May 16, 2003).

completely curtailed, with the exception of livestock. The Company is required to notify customers by changing sign postings, emailing, and posting a sign in the Pine Post Office.

Stage 4 (orange): Water storage or production is less than 65%, but at least 55% of capacity for 24 consecutive hours. Mandatory water restrictions are put into place and customers can be disconnected for not complying.

Stage 5 (red): Water storage or production is less than 55% of capacity for 12 consecutive hours. Similar to Stage 4, mandatory water restrictions are put into place.⁹³

Customers are notified of the Stages via a bill stuffer and the posting of the Stage colors on flags throughout the service territory.⁹⁴

The Bella Vista Water Company implemented a similar curtailment tariff, but found that some customers violated the mandatory curtailment measures. Bella Vista claimed it had few ways to force customers to abide by the curtailment stages and wanted to impose a presumptive violation of the advanced stages of the tariff. Under the Company's proposal to amend the tariff on its Southern system, customers using more than 600 gallons per day or 18,000 gallons per month during Stages 4 and 5 (when outdoor uses were prohibited) were presumed to be using water for those prohibited purposes.⁹⁵ The curtailment tariff approved by the Commission in *Bella Vista Water Co.* permits the Company to shut customers off with prescribed notice requirements, if they are issued a presumptive violation.⁹⁶ However, concerned about the effect the presumptive violation and ensuing shut-offs would have on customers, the Commission required the Company to follow strict notification guidelines aimed at providing the maximum amount of notice to customers.⁹⁷ Specifically, the Commission altered Bella Vista's curtailment notice proposal to require the Company to give presumptive violators two business days' notification that they are believed to be in violation of the tariff prior to shutting the customer's water off.⁹⁸ Customers, during those two days, may present evidence to the Company that their water usage was higher than the allowed 600 gallons per day as a result of permitted water uses.⁹⁹ The customer, pursuant to normal Commission rules, could also lodge a complaint against the Company at the Commission, which would be addressed by the Commission's Consumer Services Section.¹⁰⁰ The Commission also mandated that when taking special meter readings designed to demonstrate whether the customer was in violation, the Company must notify the customer of the reading and not charge the customer for it.¹⁰¹

93. *Id.*

94. *Id.*

95. *See Bella Vista Water Co.*, Decision No. 67505, Docket No. W-02465A-04-0692, at 2.

96. *Id.* at exhibit A.

97. *See id.*

98. *Id.* at 4.

99. *Id.*

100. *Id.* at exhibit A.

101. *Id.* at 4.

VII. FORCED CONSERVATION THROUGH HOOK-UP MORATORIUMS WHEN ALL ELSE HAS FAILED

In recent years, the Commission has been among the few Arizona governmental entities to implement a comprehensive hook-up moratorium on a water system, a draconian but sometimes necessary method of conserving water supplies and staunching a downward spiral by a water company. On two recent occasions the Commission imposed a comprehensive moratorium either to address chronic water shortages caused by drought conditions, or to prevent the exacerbation of problems caused by the failure of the water company to invest in the water system's infrastructure, which had led to repeated outages on the system. In these instances, the Commission took the extraordinary step of preventing further connections to the water system, a de facto prohibition on development in the area in one case, and a severe restriction on growth in the other.¹⁰²

A. Pine Water Company

Since 1989, the water-shortage-prone Pine Water Company has operated under some form of hook-up restriction.¹⁰³ In 1989, the Commission established a total moratorium on new hook-ups. It allowed 10 connections per month beginning in 1990, lowered the limitation to one per month in 1996, and raised it again to 25 hook-ups per month in December 2002.¹⁰⁴ The company was required in a subsequent decision to present the Commission with semi-annual reports on the status of its water supply, and Staff was directed to use that information in drafting a recommendation for the Commission regarding the need for continuation or alteration of the 25 per month hook-up restriction.¹⁰⁵ On November 19, 2004, Staff filed a compliance report recommending the Commission adopt a complete prohibition on new connections to the Pine Water Company, citing the Company's reliance on a pipeline importing water from the Strawberry Water Company into Pine, as well as summertime water hauling, to meet the summertime demands of

102. The Commission recently addressed a third proposed hook-up moratorium in *Desert Hills Water Co.*, Decision No. 68780, Docket No. W-02124A-06-0379 (Ariz. Corp. Comm'n June 19, 2006). In this case, the Commission was presented with a well-capitalized water company that had failed to invest in adequate water infrastructure to serve a growing population in north Phoenix, resulting in numerous outages and water quality complaints. Staff recommended the Order to Show Cause, which would require, among other remedies, a hook-up moratorium until the issues facing the company are resolved. During the pendency of the case, however, the Company was purchased by the nearby Town of Cave Creek. Both the proposed purchase and the Order to Show Cause are currently pending before the Commission.

103. Pine, Arizona sits atop fragmented rock formations that rely on rain and snow melt for groundwater collections. Groundwater is the main source of water for the Pine Water Company. See *Pine Water Co.*, Decision No. 67823, Docket No. W-03512A-03-0279, at 3 (Ariz. Corp. Comm'n May 5, 2005).

104. See MARLIN SCOTT, JR., ARIZ. CORP. COMM'N, COMPLIANCE STAFF REPORT FOR PINE WATER COMPANY PER DECISION NO. 67166, at 1 (2004) (Docket No. W-03512A-03-0279) (on file with author); see also *Pine Water Co.*, Decision No. 64400, Docket No. W-03512A-01-0764, at 8 (Ariz. Corp. Comm'n Jan. 31, 2002).

105. See *Pine Water Co.*, Decision No. 65435, Docket No. W-03512A-01-0764, at 2 (Ariz. Corp. Comm'n Dec. 9, 2002).

the existing water system, and the potential long-term detriments of the pipeline to the Strawberry system.¹⁰⁶ In its most recent action on the Pine Water Company, the Commission again lowered the allowable per month hook-ups for the company to two residential connections per month, imposed a complete moratorium on new commercial hook-ups, and prohibited any additional main extension agreements.¹⁰⁷ The Commission also imposed a May 2006 deadline for the parties to the case to arrive at a permanent solution to the company's water supply woes or face an automatic moratorium on all new residential hook-ups.¹⁰⁸ As of the writing of this Article, the Company has implemented the comprehensive moratorium.

B. McLain Water Companies

In July 2005, the customers of the McLain water systems experienced one of the longest water outages in Arizona history. The outage left the 265 customers of the Horseshoe Ranch and Cochise Water Companies without water for 16 days and caused Commissioners to ask Governor Janet Napolitano to declare an unprecedented state of emergency in the water system's service territory in order to free up funds that are available to the Governor for natural disaster recovery and other emergencies.¹⁰⁹ Ultimately, the Governor tapped funding from her Health Crisis Fund to provide a \$12,500 loan for a new well pump that resolved the short-term crisis. The outage was the latest in a string of incidents involving the dilapidated water system, which two years before had been placed under interim management¹¹⁰ by the Commission due to its previous owner's failure to make necessary improvements and repairs.¹¹¹ As a result of the recent outages and compliance problems on the McLain system, the Commission took the extraordinary step of imposing a total moratorium on new connections to the

106. See SCOTT, *supra* note 104, at 3.

107. Pine Water Co., Decision No. 67823, at 13.

108. See *id.* at 3 (discussing the Pine hook-up moratorium history).

109. The Author contacted Governor Napolitano's staff to ask for the assistance midway through the event. At the time, the systems were under interim management and were embroiled in a bankruptcy action and had no funding available to enable them to resolve the problem in a timely fashion.

110. See McLain, Decision No. 66241, Docket No. W-0146A-03-0601, at 2, 10 (Ariz. Corp. Comm'n Sept. 16, 2003).

111. The McLain water systems have been under heightened Commission scrutiny for years. Commission Staff and ADEQ officials believe the systems never had a chance, as they were constructed using sub-standard materials, had insufficient storage capacity, and suffered many other deficiencies. The Company's founder, Johnny McLain, Sr., filed bankruptcy seven times in the history of the companies. Commission Staff believe that he did so in order to skirt Commission and ADEQ jurisdiction and oversight on numerous occasions. The Commission ultimately voted to approve a purchase price for the Companies and approve Algonquin Water Resources as the new owner. Judge Eileen Hollowell of the U.S. Bankruptcy Court for the District of Arizona gave Algonquin until September 18, 2006 to finalize the purchase, which included entering into a consent decree with ADEQ regarding a schedule for coming into ADEQ compliance. Judge Hollowell allowed for additional time for closure of the sale, and as of the writing of this Article, Algonquin had closed on the purchase of the Companies, and had taken over as the new owner of the systems.

system.¹¹² In order for the moratorium to be lifted, the new owners must prove that a series of prescribed improvements be made at each water company. The improvements must be certified by the Commission Staff.¹¹³

VIII. COMMENTS ON THE NEED FOR GREATER COORDINATION BETWEEN STATE AGENCIES, COUNTIES, AND THE COMMISSION

The Commission can do much to require conservation by Arizona's 350 private water utilities through its ratemaking process.¹¹⁴ However, the discussion above regarding ADWR's ongoing rulemaking, and the Commission's role in ensuring that water companies carry out ADWR's requirements, highlights the need for heightened engagement between the executive branch and the Commission. In order to maximize the ability of each branch of government to effectuate conservation goals, the Commission, ADWR, and ADEQ should institute a process that will lead to greater information sharing regarding water company conservation efforts. This could include monthly meetings between high-level Staff at each agency and the Commission, and should include increased discussions with elected officials. It could also include increased sharing of regulatory compliance filings by water companies between executive branch agencies and the Commission. For instance, the Author recently requested that ADWR send copies to the Commission of all Letters of Adequacy that the agency issues to developers or other entities. Under normal Commission practice, developers seeking to form a water company within an AMA may file a Certificate of Assured Water Supply up to 24 months after a CC&N is issued, while those seeking to form a water company outside an AMA may file a Letter of Adequacy as late as the hearing process.¹¹⁵ Receiving ADWR's determinations with regard to water adequacy directly from the agency and upon issuance, rather than on the developer's timetable, will give the Commission greater information, and perhaps most importantly, more time to incorporate ADWR's determinations into the Commission's analysis of whether to approve a proposed water company.

IX. CONCLUSION

From the earliest days of statehood, the Commission has been called upon by virtue of its constitutionally-driven, exclusive jurisdiction over public service corporations to meet the evolving challenges faced by private water utilities. As Arizona's seemingly unbounded growth continues, the Commission will increasingly be faced with questions of how to encourage and require conservation

112. Miracle Valley Water Co., Decision No. 68272, Docket No. W-01646A-05-0509, at 13 (Ariz. Corp. Comm'n Nov. 8, 2005).

113. See N. Sunrise Water Co., Decision No. 68826, Docket No. W-20453A-06-0247, at 24 (Ariz. Corp. Comm'n June 29, 2006).

114. See discussion *supra* Part I regarding the Commission's broad constitutional and statutory authority.

115. See the preceding discussion of the Commission's decision to begin utilizing the Order Preliminary for water company applications outside AMAs. While this would prevent a developer from filing a Letter of Adequacy after the CC&N is granted, it would still permit a developer to hold on to a Letter of Adequacy (or inadequacy) until the date of a Commission hearing.

by water companies. The Commission has already established a record of encouraging and mandating conservation by water companies through tiered water rates, mandated use of effluent, required water loss improvements and the use of Orders Preliminary outside AMAs. The Commission should build on these efforts by expanding its use of acquisition adjustments, as well as using rate premiums to encourage the consolidation of small water companies, thereby improving the opportunities for conservation at small water utilities. The Commission should also emphasize its receptiveness to rate recovery applications that include spending by companies on prudent and necessary conservation programs, and establish its willingness to consider tariff filings by companies that implement mandatory water conservation by consumers. Finally, the Commission should forge a more regularized relationship with executive branch agencies that will facilitate greater information sharing and maximize the effectiveness of conservation efforts of water companies.